

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA
SACRAMENTO DIVISION

In re)	Case No. 08-26813-A-9
CITY OF VALLEJO,)	Docket Control No. OHS-4
)	
Debtor.)	
_____)	

MEMORANDUM

On June 17, 2008, the City of Vallejo filed a Motion for Approval of Rejection of Collective Bargaining Agreements. The collective bargaining agreements (CBAs) affected by the motion are between the City and the Vallejo Police Officers Association ("VPOA"), the International Association of Firefighters, Local 1186 ("IAFF"), the International Brotherhood of Electrical Workers, Local 2376 ("IBEW"), and the Confidential, Administrative, Managerial and Professional Association of Vallejo ("CAMP").

VPOA, IAFF, and IBEW filed opposition to the motion, as did the California Public Employees' Retirement System ("CalPERS"), the California Labor Federation, AFL-CIO ("California Labor

1 Federation"), and the Official Unsecured Creditors Committee of
2 Retirees ("Retirees' Committee").

3 The court commenced an evidentiary hearing on February 3,
4 2009 and concluded it on February 10, 2009. Marc A. Levinson,
5 Norman C. Hile and Michael Weed appeared for the City. Kelly A.
6 Woodruff, Dean M. Gloster, Laura Roche, and Racheal Turner
7 appeared for IAFF and IBEW. Steven H. Felderstein and Joan S.
8 Huh appeared for CalPERS. R. Dale Ginter appeared for the
9 Retirees' Committee. Donald C. Carroll appeared for California
10 Labor Federation. Robert Kaplan and Nicolas DeLancie appeared
11 for creditor Union Bank. Mike C. Buckley appeared for creditor
12 Wells Fargo Bank.

13 On January 27, 2009, the Vallejo City Council approved a
14 supplemental agreement between the City and VPOA. At the
15 evidentiary hearing, the City voluntarily dismissed the motion
16 with respect to VPOA.

17 On January 30, 2009, CAMP approved a proposed supplemental
18 agreement with the City. On February 10, 2009, the City Council
19 approved the supplemental agreement, and the City then
20 voluntarily dismissed the motion as to CAMP.

21 Consequently, the motion before the court seeks to reject
22 only the CBAs between the City and the IAFF and the IBEW.

23
24 I

25 This Memorandum addresses whether chapter 9 of the
26 Bankruptcy Code permits a municipality to reject collective
27 bargaining agreements with its public employee unions.

28 ///

1 A

2 The United States Constitution authorizes Congress to enact
3 uniform bankruptcy laws. U.S. Const. art. 1, § 8, cl. 4. By
4 virtue of the Supremacy Clause, federal laws are the supreme law
5 of the land, notwithstanding state laws to the contrary. U.S.
6 Const. art. VI, cl. 2.

7 The Constitution also reserves certain powers to the states.
8 The Tenth Amendment provides: "The powers not delegated to the
9 United States by the Constitution, nor prohibited by it to the
10 States, are reserved to the States respectively, or to the
11 people."

12 To harmonize these two competing interests - reservation of
13 powers to the states and the supremacy of federal bankruptcy
14 law - Congress enacted 11 U.S.C. § 903. Section 903 provides, in
15 relevant part:

16 This chapter does not limit or impair the power of a
17 State to control, by legislation or otherwise, a
18 municipality of or in such State in the exercise of the
political or governmental powers of such municipality
. . . ."

19 11 U.S.C. § 903.

20 Section 903 ensures the constitutionality of chapter 9, but
21 does not provide an independent substantive limit on the
22 application of chapter 9 provisions. As explained in 6 *Collier*
23 *on Bankruptcy* ¶ 903.02[2] (Alan N. Resnick and Henry J. Sommer
24 eds. 15th ed. rev.):

25 As a constitutional shield for chapter 9, the
26 introductory language of section 903 has no general
relevance to the interpretation or application of any
of the specific substantive provisions of chapter 9.
27 Indeed, unlike section 904, section 903 does not act as
an independent substantive limitation on actions of the
28 bankruptcy court in applying the provisions of chapter

1 9"

2 Id. at ¶ 901.09[9][a]. See also Ryan Preston Dahl, "Collective
3 Bargaining Agreements and Chapter 9 Bankruptcy," 81 Am. Bankr.
4 L.J. 295, 329-338 (Summer 2007) (noting that "constitutional
5 guarantees of state sovereignty are not violated by a municipal
6 debtor's independent exercise of bankruptcy-specific rights.").

7 Section 903, together with 11 U.S.C. § 109(c)(2), allows
8 states to act as gatekeepers to their municipalities' access to
9 relief under the Bankruptcy Code. When a state authorizes its
10 municipalities to file a chapter 9 petition it declares that the
11 benefits of chapter 9 are more important than state control over
12 its municipalities.

13 Therefore, "[b]y authorizing the use of chapter 9 by its
14 municipalities, California must accept chapter 9 in its totality;
15 it cannot cherry pick what it likes while disregarding the rest."
16 In re County of Orange, 191 B.R. 1005, 1021 (Bankr. C.D. Cal.
17 1995) ("Orange County III"); see also Collier, at ¶ 903.02[4].

18 Consequently, if a municipality is authorized by the state
19 to file a chapter 9 petition, it is entitled to fully utilize 11
20 U.S.C. § 365 to accept or reject its executory contracts. See 11
21 U.S.C. § 901 (making section 365 fully applicable in chapter 9
22 cases). See also 81 Am. Bankr. L.J. at 333 ("Any attempt to
23 limit a debtor's rights under § 365 through recourse to state
24 sovereignty must also be weighed against the filing requirements
25 unique to Chapter 9. . . . Since the state must consent to a
26 bankruptcy filing under § 109(c)(2), the state consents to the
27 displacement of its own law in order to obtain the benefits
28 uniquely available under the Bankruptcy Code."); cf. In re County

1 of Orange, 179 B.R. 185, 191 (Bankr. C.D. Cal. 1995) ("Orange
2 County II") (discussing relationship between Sections 362 and
3 903).

4
5 B

6 The California statute authorizing its municipalities to
7 file bankruptcy petitions provides: "Except as otherwise provided
8 by statute, a local public entity in this state may file a
9 petition and exercise powers pursuant to applicable federal
10 bankruptcy law." Cal. Gov't Code § 53760. "This section is
11 intended to provide the broadest possible state authorization for
12 municipal bankruptcy proceedings, and thus provides the specific
13 state law authorization for municipal bankruptcy filing required
14 under federal law." Cal. Gov't Code § 53760 (Law Revision Comm'n
15 Comments, 2002 Addition) (emphasis added).

16 With respect to the prefatory phrase, "Except as otherwise
17 provided by statute," in section 53760, neither it nor any other
18 California law imposes pre-filing limitations or post-filing
19 restrictions requiring compliance with, or making applicable,
20 public sector labor laws. The 2002 Comments to section 53760
21 identify various California statutes that do impose such
22 limitations, and state labor law is not among them:

23 As recognized in the introductory clause of subdivision
24 (a), this broad grant of authority is subject to
25 specific limitations provided by statute. See, e.g.,
26 Ins. Code § 10089.21 (California Earthquake Authority
27 precluded from resort to bankruptcy); Sts. & Hy. Code §
28 9011 (prerequisites to bankruptcy filing under
Improvement Bond Act of 1915). See also Educ. Code §
41325 (control of insolvent school district by
Superintendent of Public Instruction); Health & Safety
Code § 129173 (health care district trusteeship).

1 Cal. Gov't Code § 53760 (Law Revision Comm'n Comments, 2002
2 Addition).

3
4 C

5 Assuming for sake of argument that California law
6 superimposes its labor laws onto section 365, such law would be
7 unconstitutional. As noted above, only the federal government
8 may enact uniform bankruptcy laws. U.S. Const. art. 1, § 8, cl.
9 4. "[I]ncorporat[ing] state substantive law into chapter 9 to
10 amend, modify or negate substantive provisions of chapter 9 would
11 violate Congress' ability to enact uniform bankruptcy laws."
12 *Collier*, at ¶ 903.01; see also *Cent. Va. Cmty. Coll. v. Katz*, 546
13 U.S. 356 (2006); 81 Am. Bankr. L.J. at 334 ("'[U]niform nature of
14 federal bankruptcy power may preempt objections to the
15 application of bankruptcy law predicated on state sovereignty.");
16 Randolph J. Haines, "The Uniformity Power: Why Bankruptcy is
17 Different," 77 Am. Bankr. L.J. 129, 174 (2003) ("[T]he power
18 granted to Congress by the Framers did not merely override the
19 states' reserved legislative authority, as did the Supremacy
20 Clause, but completely alienated . . . all of the states'
21 sovereignty with respect to that body of law").

22 The Supremacy Clause invalidates state laws that "'interfere
23 with or are contrary to federal law.'" U.S. Const. art VI, cl.
24 2; Baker & Drake, Inc. v. Pub. Serv. Comm'n of Nev., 35 F.3d
25 1348, 1352 (9th Cir. 1994) (citing Gibbons v. Ogden, 22 U.S. 1,
26 211 (1824)).

27 Under the Contracts Clause, modification of contracts is
28 within the exclusive province of the federal government. U.S.

1 Const. art. VI; see Cont'l Illinois Nat'l Bank & Trust Co. v.
2 Chicago, R.I. & P. Ry. Co., 294 U.S. 648, 680-81 (1935).

3 In the exercise of this exclusive power, Congress enacted
4 section 365 to provide debtors the authority to reject executory
5 contracts. 11 U.S.C. § 365(a). This authority preempts state
6 law by virtue of the Supremacy Clause, the Bankruptcy Clause, and
7 the Contracts Clause. U.S. Const. art. 1, § 8, cl. 4; U.S.
8 Const., art. VI, cl. 2; U.S. Const., art. IV.

9 Therefore, the court must reject the assertion that Sonoma
10 County Organization of Public Employees v. County of Sonoma, 23
11 Cal. 3d 296 (1979), or any state labor law, provides the
12 applicable standard controlling the rejection of the City's
13 collective bargaining agreements.

14 Where a state law "unduly impede[s] the operation of federal
15 bankruptcy policy, the state law [will] have to yield." Perez v.
16 Campbell, 402 U.S. 637, 649 (1971); Sherwood Partners Inc. v.
17 Lycos, Inc., 394 F.3d 1198, 1203 (9th Cir. 2005).

18 Sonoma, state labor law applicable outside of the bankruptcy
19 context, and the contracts clause of the California Constitution,
20 Article I, Section 9, do not apply to the City's rejection of its
21 collective bargaining agreements because they conflict with
22 section 365 and the Bankruptcy Code. They are preempted. U.S.
23 Const. art. 1, § 8, cl. 4; art. VI, cl. 2; art. IV.

24
25 D

26 Unexpired collective bargaining agreements are executory
27 contracts subject to rejection under section 365. See N.L.R.B.
28 v. Bildisco & Bildisco, 456 U.S. 513, 521-22 (1984). Congress

1 incorporated section 365 into chapter 9 without restricting or
2 limiting its application to collective bargaining agreements.
3 See Bildisco, 465 U.S. at 522 (discussing the types of other
4 agreements excluded from section 365, and concluding that labor
5 agreements are executory contracts that can be rejected).

6 Congress enacted 11 U.S.C. § 1113 following the Supreme
7 Court's decision in Bildisco. See In Re County of Orange, 179
8 B.R. 177, 182 (Bankr. C.D. Cal. 1995) ("Orange County I").
9 Section 1113 applies in chapter 11 cases and imposes on chapter
10 11 debtors procedural and substantive requirements that must be
11 met prior to rejection of collective bargaining agreements.

12 Section 1113, however, is not incorporated into chapter 9.
13 See 11 U.S.C. § 901(a); Orange County I, 179 B.R. at 181 n.8.

14 Therefore, section 1113 is not applicable in chapter 9
15 cases, and a chapter 9 debtor is not required to comply with it
16 in order to reject an executory collective bargaining agreement.
17 See Orange County I, 179 B.R. at 183 ("Given this history, I
18 conclude that Bildisco applies in Chapter 9 since Congress has
19 had numerous opportunities to limit its effect by incorporating §
20 1113 into Chapter 9."); *Collier*, at ¶ 901.04[9][a].

21 In 1991, Congress considered adding a provision to chapter 9
22 to require a municipal debtor to exhaust state labor law
23 procedures prior to rejecting a collective bargaining agreement.
24 See Orange County I, 179 B.R. at 182-83; The Municipal Employee
25 Protection Amendments of 1991, H.R. 3949, 102d Cong., 1st Sess.
26 (1991).¹ The proposed statute provided: "The debtor which seeks
27

28 ¹ The Municipal Employee Protection Amendments of 1991,
H.R. 3949, 102d Cong., 1st Sess. (1991), were introduced as House

1 approval of changes to a labor agreement [must first exhaust all]
2 state law procedures for the bargaining, implementation, and
3 amendment of a collective bargaining agreement." Orange County
4 I, 179 B.R. at 183 n.15.

5 Congress, however, did not enact this proposed amendment to
6 the Bankruptcy Code. And, this court will not presume to do what
7 Congress has not done, whether by incorporating section 1113-like
8 provisions into chapter 9, or by requiring compliance with state
9 labor law.

10
11 F

12 As established by the Supreme Court in Bildisco, a debtor
13 may utilize section 365 to reject an unexpired collective
14 bargaining agreement if the debtor shows that: (1) the collective
15 bargaining agreement burdens the estate;² (2) after careful
16 scrutiny, the equities balance in favor of contract rejection;
17 and (3) "reasonable efforts to negotiate a voluntary modification
18 have been made, and are not likely to produce a prompt and
19 satisfactory solution." Bildisco, 456 U.S. at 526. The debtor
20 has the burden of establishing that these factors have been
21 satisfied. Id.

22
23
24 Resolution 3949 by Representative Howard L. Berman on November
25 26, 1991. Among its legislative goals was the "contemplated
enact[ment of] a "\$ 1113-like" statute for chapter 9. See Orange
County I, 179 B.R. at 183 n.15. The bill died in committee. Id.

26 ² In a chapter 9 case there is no "estate." Thus, a
27 municipal debtor must demonstrate that the collective bargaining
28 agreement burdens its ability to reorganize by proposing and
implementing a viable plan of adjustment. Bildisco, 456 U.S. at
525-26.

II

Despite having concluded that the City may potentially reject the remaining CBAs, the court will defer determining whether the City has satisfied the Bildisco standard for their rejection for two reasons.

The court was advised several times at the evidentiary hearing on the motion, and again at the hearing on a related motion by IAFF for relief from the automatic stay, that negotiations between the City, IAFF, and IBEW were ongoing. The court wishes to give the parties every reasonable opportunity to settle this motion. Given the settlements with two of the unions, the court wishes to do give the City and the remaining two unions every reasonable opportunity to come to terms. After all, Bildisco permits the City to reject the CBAs only if negotiation is unlikely to produce a prompt and satisfactory solution.

Also, in the court's findings and conclusions concerning the City's eligibility for chapter 9 relief, the court noted that the City had over 100 special purpose and enterprise funds with cash and investments totaling approximately \$136 million. The Unions maintained that these funds could be tapped by the City to solve its financial problems. The court concluded that the cash and investments in these funds were not available to cover the operating expenses of the City's General Fund.

Nonetheless, in connection with the hearing on this motion, the City's evidence indicated that some of its labor costs are apportioned to some of these funds.

1 The court would like further evidence and authority
2 concerning the apportionment of these labor costs. For instance:

3 - Which funds are apportioned these costs?

4 - How much of the City's labor costs are borne by the
5 General Fund as opposed to one of the other funds?

6 - Under what authority are labor costs shifted from the
7 General Fund to the other funds?

8 - Are any of the other funds not paying for labor costs that
9 should be borne by them under applicable contract or
10 authority?

11 Therefore, the court will conduct a brief status conference
12 on March 23, 2009 at 1:30 p.m. Counsel may appear in person or
13 by telephone. At the conference, the court wishes to be updated
14 on the status of negotiations between the parties and, assuming
15 there is no compromise, to discuss reopening the record so that
16 the parties may address the court's additional questions.

17 Dated:

By the Court

18 /s/
19

20

Michael S. McManus
United States Bankruptcy Judge